VZCZCXYZ0057
RR RUEHWEB

DE RUEHQT #1026/01 2931938
ZNR UUUUU ZZH
R 201937Z OCT 09
FM AMEMBASSY QUITO
TO RUEHC/SECSTATE WASHDC 0210
INFO RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUEHBO/AMEMBASSY BOGOTA
RUEHCV/AMEMBASSY CARACAS 0072
RUEHGL/AMCONSUL GUAYAQUIL
RUEHLP/AMEMBASSY LA PAZ OCT LIMA 0086

UNCLAS QUITO 001026

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: ECON ETRD EINV EFIN EC
SUBJECT: ECUADOR ECONOMIC NEWS: ECONOMY CONTRACTS, BALANCE OF PAYMENTS IMPROVES, ELECTRICITY SHORTAGES, REDUCTION OF SAFEGUARDS ON COLOMBIAN PRODUCTS

REF: QUITO 060; QUITO 837; QUITO 938; CARACAS 1284

¶1. (U) The following is a periodic economic update for Ecuador that reports notable developments that are not reported by individual cables. This document is sensitive but unclassified. It should not be disseminated outside of USG channels and should not be posted on the internet.

Highlights

- Ecuador's GDP Shrinks for Third Straight Quarter

- Improvement in Balance of Payments

- GoE Reduces Safeguards on Colombian Products

- Brazil to Eliminate Tariffs on 3,200 Ecuadorian Products

- Ecuador Could Face Electricity Shortages in Short-term

- Ecuador to Use IMF SDRs to Fund Banco del Sur

--- ---

Ecuador's GDP Shrinks for Third Straight Quarter

--- ---

¶2. (U) Ecuador's economy is experiencing a sharp recession after recording the third straight quarter of negative growth. According to Central Bank (CBE) statistics, real GDP shrank on a quarter-to-quarter basis by 0.26% in the second quarter of 2009. This followed contractions of 1.31% and 0.25% in the first quarter of 2009 and the final quarter of 2008. Eight of fourteen economic sectors reported quarterly contractions in the second quarter of 2009: direct financial intermediation (-1.63%), commerce (-1.25%), agriculture (-0.92%), indirect financial intermediation (-0.79%), mining and oil (-0.57%), manufacturing (-0.49%), public administration (-0.35%), and other services (-0.09%). The six sectors recording growth were: water and electricity (14.28%),

private households (2.98%), construction (2.84%), transport and storage (1.95%), oil refining (0.89%), and fisheries (0.13%). Positive growth in the water and electricity sector reflected substantial government investment in basic services.

¶3. (U) On a year-over-year basis, the economy shrank by 1.06% in the second quarter, the first annual fall since the second quarter of 2003. Eight economic sectors contracted on a year over year basis including petroleum refining (-7.17%), indirect financial intermediation (-6.24%), commerce (-4.13%), agriculture (-3.04%), and mining and oil (-2.2%). There was growth in public administration (6.68%), construction (5.95%) and transportation and storage (3.52%) sectors.

¶4. (U) The continued contraction of Ecuador's economy largely reflects the fall in international oil prices from their highs in 2008, and the impact of the global financial crisis. In the second quarter of 2009, household consumption was down by 1.42% year over year, government expenditure by 0.28%, and private investment by 2.57%. The unemployment rate rose from 7.3% in December 2009 to 8.3% in June 2009 with an additional 51.7% of the workforce

considered as underemployed. (Note, the unemployment rate continued to deteriorate reaching 9.1% in September.) On the external side of the economy, imports fell by 6.32% while exports contracted by 0.06% during the second quarter of 2009, resulting in an improvement in the trade balance.

¶5. (U) The CBE has reduced its forecast of real GDP growth from 3.5% to 1% for 2009, while the IMF projects a 1% real contraction. In 2008, the Ecuadorian economy grew by 6.5%. Most analysts consider the CBE forecast to be optimistic considering the substantial growth that would be required in the last six months of the year to produce a 1% annual growth rate. Private investment shows no signs of recovery and is dependent on government investment, which is constrained by limited resources. Remittances continue to be lower than in 2008 and internal demand has been decreasing.

Improvement in Balance of Payments

¶6. (U) Central Bank of Ecuador (CBE) statistics show an improvement in the country's global balance of payments, with a deficit reduction from US$ 1.33 billion in the previous quarter to a deficit of US$ 605 million in the second quarter of 2009. Ecuador's capital account deficit worsened in second quarter 2009, but was compensated by a larger than expected current account surplus. The GOE's repurchase of some global bonds during the same period caused international reserves to fall overall to about US$ 2.6 billion as of end-June. (Note, by early October international reserves had rebounded to about US$ 4.6 billion).

¶7. (U) Ecuador recorded a trade surplus of US$ 194 million for the second quarter of 2009 as exports expanded and imports declined. This compares to the trade deficit of US$ 735 million recorded in the previous quarter. The trade surplus coupled with the 10% increase in remittances from abroad over the previous quarter brought the current account surplus to US$ 87 million, up from a deficit of US$ 889 million in the previous quarter. Despite an increase in foreign direct investment in-flows, the deficit in the

capital account increased from US$ 445 million in the first quarter of 2009 to US$ 692 million in the second quarter of 2009.

GoE Reduces Safeguards on Colombian Products

¶8. (U) Effective October 15, Ecuador's Trade and Investment Council (COMEXI) removed exchange rate safeguards on 319 Colombian products. In January 2009, Ecuador imposed balance of payment (BoP) safeguard measures broadly on a number of imports (Ref A). In July 2009, the GoE decided that for 1,346 products from Colombia, it would apply the BoP safeguard tariffs on top of Ecuador's WTO bound tariff rate, instead of applying it to the preferential tariff rate Colombia normally enjoyed as one of Ecuador's Andean Community trading partners. Ecuador justified the action claiming devaluation of Colombia's peso had unfairly damaged Ecuador's competitiveness. After an Andean Community decision that went against Ecuador, the GoE reduced the number of affected products by roughly one-half and agreed to eliminate safeguards on the remaining products in three stages (Ref B). Following the most recent action, safeguards remain on about 350 Colombian products. All safeguards are expected to be removed by the end of the year.

-- ----------

Brazil to Eliminate Tariffs on 3,200 Ecuadorian Products

-- ----------

¶9. (U) On October 2, Ecuador's Vice Minister for Trade, Julio Oleas, announced that Brazil had agreed to eliminate tariffs on 3,200 Ecuadorian products. This measure, which still needs to be approved by the Latin American Association for Integration (ALADI), would benefit Ecuadorian exports of fish, mollusks, fruit, animal or vegetable fats and oils, cooked meat, vehicles and accessories and parts. Bananas are not included on the list. In 2008, Ecuador recorded a trade deficit with Brazil of about US$ 796 million.

-- ---------

Ecuador Could Face Electricity Shortages in Short-term

-- ---------

¶10. (U) On September 29, Colombian Minister of Mining and Energy, Hern????n Martinez, announced that Colombia would gradually restrict electricity exports to Ecuador and Venezuela to better meet domestic demand. Roughly 55% to 75% of the energy consumed in Ecuador is supplied by hydroelectric plants, 25%-32% by thermoelectric plants, with energy imports from Colombia fluctuating between 5% and 12%. According to Ecuador's National Center for Energy Control (CENACE), energy demand in Ecuador ranges from 2,500 megawatts (MW) to 2,900 MW and is expected to grow at an annual rate of 5%. Ecuador currently only has about 3,000 MW of installed energy generation capacity with 500-1,000 MW out of commission at any one time.

¶11. (U) Initially the GoE had hoped to double energy generation capacity by 2012 through 17 planned projects. However, many of these projects have been delayed. The government's revised estimate is that seven of the 17 projects will come on-line by 2014

to provide an additional 1,115 MW capacity. Only four of these seven projects are currently under construction: Mazar, Toachi-Pilaton, Ocana, and Baba. Together they would generate only an additional 456 MW. The most advanced project is the US$460 million, 160 MW hydroelectric power plant Mazar, which the GoE expects to have on-line by March 2010. However, that will not adequately cover the loss of energy from Colombia. The Baba hydroelectric plant, slated to enter operation by the end of 2010, will add only 42 MW in capacity. Ocana (26 MW) and Toachi-Pilaton (228 MW) hydroelectric plants aren't expected to be operational until 2011 and 2014, respectively. The GoE's largest electricity generation project on the books is the $2 billion Coca Codo Sinclair 1500 MW hydroelectric plant which will not be complete until 2015 or later. In early September, China's Sinohydro was awarded the construction contract with financing by China's Ex-Im Bank (ref C).

Ecuador to Use IMF SDRs to Fund Banco del Sur

¶12. (U) On September 27, Argentina, Brazil, Bolivia, Ecuador, Paraguay, Uruguay, and Venezuela signed the Constitution Agreement of the Banco del Sur during the Latin American and African Countries Summit on Margarita Island (Ref D). President Correa has publicly described Banco del Sur as a mechanism to "finance development projects." According to news reports, Banco del Sur's authorized capital will grow from US$ 7 billion to US$ 20 billion in ten years. Argentina, Brazil and Venezuela will reportedly contribute US$ 2 billion each and, Bolivia, Ecuador, Paraguay and Uruguay will contribute lower, differing amounts. Press reports note that although each country will have the same voting rights on the board of directors, loans greater than US$70 million will require the support of two thirds of the bank's paid capital voting rights, giving Venezuela, Argentina, and Brazil a larger representation. According to Ecuador's Coordinating Minister for Economic Policy Diego Borja, Ecuador will contribute US$ 70 million per year for 10 years to the new bank. The first contribution will be funded out of the roughly US$ 400 million Ecuador obtained through the IMFs allocation of Special Drawing Rights (SDRs) in August and September.
HODGES